

# SUMMARY ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Figueroa Analyst: Jeani Brent Bill Number: SB 495

Related Bills: None. Telephone: 845-3410 Amended Date: 04/13/1999

Attorney: Doug Bramhall Sponsor:

**SUBJECT:** Employer New Full-Time Space Vehicles, Parts, Satellites, and Equipment  
Employee Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 18, 1999.

☒ FURTHER AMENDMENTS NECESSARY.

☒ DEPARTMENT POSITION CHANGED TO Pending.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 18, 1999 STILL APPLIES.

OTHER - See comments below.

### SUMMARY OF BILL

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, this bill would allow a credit of \$1,000 for each qualified new employee employed by the taxpayer during the taxable or income year and engaged in activities related to space vehicles and parts and space satellites and equipment.

### SUMMARY OF AMENDMENT

The April 13, 1999, amendments deleted the provisions regarding employees engaged in qualified research and added the provisions regarding employees engaged in activities related to space vehicles and parts and space satellites and equipment.

The amendments resolved one of the department's implementation considerations, relating to the flow through to investors of a pass-through entity, by deleting the reference to the research credit. Except for that implementation consideration, the discussion of "this bill," revenue estimate, and Board position, the department's analysis of the bill as introduced still applies.

### SPECIFIC FINDINGS

**This bill** would allow a credit of \$1,000 for each qualified employee employed by the taxpayer during the taxable or income year. A qualified employee would be all of the following:

1. A "new" employee, which is an employee who fills a newly created position that results in an overall net gain to the number of employees.
2. A full-time employee, which is an employee who works at least 35 hours per week.

#### Board Position:

|                             |                              |   |
|-----------------------------|------------------------------|---|
| <input type="checkbox"/> S  | <input type="checkbox"/> NA  | <input type="checkbox"/> NP                 |
| <input type="checkbox"/> SA | <input type="checkbox"/> O   | <input type="checkbox"/> NAR                |
| <input type="checkbox"/> N  | <input type="checkbox"/> OUA | <input checked="" type="checkbox"/> PENDING |

Department/Legislative Director Date

**Johnnie Lou Rosas** **4/27/1999**

3. Hired on or after January 1, 2000.
4. Employed by the taxpayer for more than six months, but less than three years at the end of the taxpayer's taxable or income year.
5. Engaged in activities related to space vehicles and parts and space satellites and equipment, as specified by certain Standard Industrial Classification (SIC) codes.

The following SIC code industry sectors would be included:

| SIC Code | Industry Sector Description   |
|----------|---|
| 3663     | Radio and television broadcasting and communications  |
| 3761     | Guided missiles and space vehicles, including research and development  |
| 3764     | Guided missile and space vehicle propulsion units and propulsion unit parts, including research and development |
| 3769     | Guided missile and space vehicle parts and auxiliary equipment, including research and development              |
| 3812     | Search, detection, navigation, guidance, aeronautical, and nautical systems and instruments                     |

The term "qualified employee" would not include any person previously employed by the taxpayer within the year prior to the taxable or income year. Thus, employees rehired in the taxable or income year following a year during which the taxpayer employed the employee would not qualify.

Any portion of the credit not used in the taxable or income year could be carried over to future years until exhausted.

If the taxpayer is eligible to claim this credit, the research credit, or the enterprise zone hiring credit on the same employee, the taxpayer may elect to take this credit and that election would be in lieu of claiming the other credits.

Since **this bill** does not specify otherwise, the general rules in state law regarding the division of credits among taxpayers would apply, and this credit would not reduce regular tax below tentative minimum tax for the purposes of alternative minimum tax.

#### Policy Considerations

This credit would not be limited to employees hired in California. The department understands that the bill is being amended to resolve this concern.

The lack of a quantitative basis for evaluating the extent of employee services necessary for the credit, as discussed in the implementation consideration identified as #1 below, could result in manipulation of the use of the credit.

### Implementation Considerations

The following implementation considerations addressed in the department's analysis of the bill as introduced still apply and are provided below for convenience:

1. To be a "qualified employee," this bill would require the employee be "engaged in activities" related to the specified industry sectors. However, this bill does not provide a quantitative basis for evaluating to what extent the employee's services must be related to those industry sectors. Specifically, this bill does not specify the type or amount of services required to be performed in order for an employee to be a "qualified employee" (e.g., a one-hour meeting of all employees at which space vehicle ideas are solicited potentially could qualify all employees in the credit base). Further, the bill does not specify the time period required for the net gain in employment (time of hiring versus end of year).

Other existing hiring credits do provide quantitative bases. For instance, under the enterprise zone hiring credit, 90% of the employee's services must be directly related to the employer's enterprise zone business and at least 50% of the employee's services must be conducted in the enterprise zone. This bill, because it does not specify a quantitative basis, would allow the taxpayer to claim a \$1,000 credit for an employee who engages in any services related to the specified industry sectors, from occasional to full-time.

2. By providing that "qualified employee" includes employees employed less than three years, it appears that the intent would be to allow the taxpayer to take the credit for the first three years of employment of that employee. However, the bill also states that "qualified employee" shall not include any person previously employed by the taxpayer within the year prior to the taxable or income year, which appears to disallow the second and third years of the credit. Therefore, it is unclear whether taxpayers would be allowed the credit for three years of employment or only for the first year in which the employee is employed.
3. This bill states that a "new" employee is one who fills a "newly created position." This requirement leaves unclear whether the position must be newly created in the current taxable or income year or some earlier income or taxable year.

### FISCAL IMPACT

#### Tax Revenue Estimate

This bill is estimated to impact the personal income tax (PIT) and bank and corporation tax (B&CT) revenue as shown in the following table. The estimates assume that the bill will be amended to provide that qualified hiring must take place in California.

Note: This bill, as currently drafted, could extend to non-technical employees hired and it does not specify the time to measure the required net gain in employment. Because of these issues, the use of the credit might be

manipulated. To the extent it is, and unless this bill is amended, the potential revenue implications are uncertain, but could be significantly higher than reported below.

| Fiscal Year Cash Flow Losses<br>Effective For Hirings On Or After 1/1/2000<br>\$ Millions |               |               |                |
|---|---------------|---------------|----------------|
|   | 1999-0        | 2000-01       | 2001-02        |
| Personal Income Tax   | (Negligible*) | (Negligible*) | (Minor Loss**) |
| Bank and Corporation Tax  | (Negligible*) | -\$1          | -\$3           |
| Total   | (Negligible*) | -\$1          | -\$3           |

\* Loss less than \$250,000

\*\* Loss less than \$500,000

#### Tax Revenue Discussion

This revenue estimate differs from the previous analysis of the bill as introduced February 18, 1999, as a result of changing the group of individuals that would be "qualified employees" from those engaged in qualified research activities to only those engaged in space vehicle and space satellite activities included in SIC Codes 3761-3769, 3663, and 3812.

The revenue impact for this bill would depend upon the number of employers who hire qualified individuals engaged in SIC Codes 3761-3769, 3663, and 3812 in California and the amount of available tax liabilities of qualified employers.

The revenue shown in the above table assumes that the bill will be amended to limit the credit to employees in California and to address the implementation concerns dealing with the potential manipulation noted above. The impact of those matters could more than double the estimates provided.

This estimate was developed in the following steps. First, according to the Employment Development Department (EDD), approximately 98,000 individuals were employed in SIC Codes 3761 to 3769, 3663, and 3812 for 1998. According to the same source, it is projected that approximately 2,500 additional individuals would be hired in this research industry for 1999. Second, this number (2,500) was grown 5% per year, yielding approximately 2,625 qualifying individuals that would be hired in 2000. This number was adjusted to account for those individuals who would meet the net increase in employment to the employer (90% assumption), leaving approximately 2,360 qualifying individuals for 2000. It was further assumed that only 50% of those individuals would qualify for the credit in the year of hiring because of the minimum time requirement (six months) and the date they are hired within the year, leaving approximately 1,180 individuals for the first year (2000). Third, the total number of qualifying individuals was multiplied by \$1,000, generating \$1.2 million in generated credits for income years beginning in 2000. In subsequent years, it is assumed 85% of the previously hired individuals would qualify employers for the credit.

The following table shows the total projected number of qualifying full-time positions each year (new and continuing) with at least six months but less than three years of employment for the year.

| Qualified Positions       |              |              |              |
|---------------------------|--------------|--------------|--------------|
| Year                      | 2000         | 2001         | 2002         |
| Qualifying<br>Individuals | 1,180        | 1,240        | 1,302        |
|                           |              | 2,008        | 2,109        |
|                           |              |              | 1,707        |
| <b>Total</b>              | <b>1,180</b> | <b>3,248</b> | <b>5,118</b> |

Revenue losses take into account other credits that may apply under current law and the number of individuals who enter and those who leave the workforce. An employer who hires an employee in any given year can take a credit of \$1,000 for that same employee for up to three years, allowing one employee to qualify the employer for a maximum credit of \$3,000 over a three-year period. This is reflected in the increase in revenue losses for the out-years. Qualifying individuals were grown 5% per year. It was assumed that approximately 90% of allowable credits for PIT and B&CT would be applied against available tax liabilities in any given year by this research industry.

#### BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill as introduced February 18, 1999. The Board has not had the opportunity to review the April 13, 1999, amendments.